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Segment: CalPERS Pioneering Vision
Guests: Professor Steven Hughes, Bob McCrory, Dr. Mark Smith, and Professor William Sharpe

Video Transcript

Narrator:
All of us hope that a lifetime of hard work will be rewarded with a secure and comfortable retirement.

For most people, more than luck is required. It takes a smart investment strategy and reliance on strong, capable institutions.

Today, public employees in California can look forward to a secure retirement. It hasn't always been that way.

In the late 1920s, at California's state capital, over a stretch of many summer days a visionary concept was hotly debated. Even as the global depression took hold, a more secure future for State employees was being considered.

But a retirement system would not be attained easily. While supporters pointed out it would help attract the best people to government, opponents called it "charity."

In 1926, progressive Governor Clement Young was elected. Young established a Commission to evaluate the concept. After two years, the commission recommended establishing a public retirement system.

On Nov. 4, 1930, voters narrowly approved the required constitutional amendment and in 1931 the Legislature passed the bill creating the State Employees Retirement System.

By 1939 employees of other government agencies such as counties, cities and school districts were allowed to take part. And by 1949 classified school employees like janitors, bus drivers, and cafeteria and office workers were included.

Today the institution of CalPERS provides for 1.3 million Californians – including the current and retired employees of:

- The State Government of California
- Over 30 counties in California
- More than 1,300 cities, towns and special government districts
- And over 1000 school districts, community colleges and state universities

Professor Steven Hughes is head of the Public Policy Institute at California State University at Stanislaus.

Professor Steven Hughes:
Historically, there is a significant problem in planning for retirement in societies, taking care of older people as they finish their working years.

Ideally, a person would draw from three forms of retirement funds: a Social Security or government entitlement program, which, generally, for most people, will provide a modest amount of retirement benefit. Secondly, would be their own accumulations of savings and investments. This will vary quite a bit from individual to individual. Some will do well; some not so well. And then the third would be pension funds. For most people, particularly, I think, most members of CalPERS, the retirement benefit that CalPERS will provide them will be the single most significant benefit that they will earn in retirement.

Narrator:
CalPERS' comprehensive range of benefit plans provides the flexibility required to meet the needs of its large and diverse membership. Bob McCrory, a fellow of the Society of Actuaries explains.

Bob McCrory:
CalPERS offers three different kinds of plans. First of all there's a pension plan. It's a defined benefit plan that offers employees a benefit that's guaranteed for life.

Narrator:
In a defined benefit pension plan, a retiree receives a benefit determined by a set formula.

The CalPERS defined benefit plans use formulas based on the member's years of service, the member's age at retirement, and the highest one-year or three-year compensation period while employed.

The retirement funds generally come from three sources: employee contributions, investment returns, and employer contributions. Employee contributions are set by law. Employer contributions vary depending on investment returns and other factors.

Bob McCrory:
The second type of plan is a defined contribution plan. Those are savings plans that allow employees to build up savings that supplement their retirement.

Narrator:
CalPERS currently administers three defined contribution plans:

- A 457 Deferred Compensation Program for local public agencies and school employees
- A supplemental contributions program for state employees, judges, and legislators
- And a money purchase pension plan, available only to certain State peace officers and firefighters

Bob McCrory:
CalPERS serves as a buying agency for healthcare that employers can choose to provide health benefits to their employees.

Narrator:
Most CalPERS employers see health insurance as an important part of their employee benefit packages.

Dr. Mark Smith, President of California HealthCare Foundation, discusses CalPERS unique role in healthcare coverage.

Dr. Mark Smith:
I think many employers in California and around the country look to CalPERS for leadership in how to be a smart purchaser for health insurance, how to get the most for their money. And also how to do things like arranging benefits in a way that will control costs, but to do so in a way that hopefully minimizes the pain for its enrollees.

Narrator:
CalPERS' size helps contain healthcare costs, and positively affects the quality of healthcare coverage.

Dr. Mark Smith:
Out of all of CalPERS' enrollees there are probably several thousand people who have diseases like diabetes or asthma or, perhaps, cancers. Trying to figure out how to get them organized, systematic care, the care that the evidence suggest is best for them, is something that only a smart purchaser the size of CalPERS can really be interested in.

Narrator:
While CalPERS is the second largest public purchaser of health benefits in the nation, second only to the federal government, it is the largest public pension plan in the nation. As a public pension plan, it is, however, different from Social Security.

Bob McCrory:
CalPERS and Social Security are similar in some ways and different in others. They're similar in that both provide a guaranteed benefit for life. They're different in that CalPERS is funded.

Assets to pay the benefits are built up during the member's active working lifetime.

When the member retires, the assets are on-hand to pay their benefit for the rest of their lives.

Social Security doesn't build up a pool of assets while the member is working. No big pool of assets is on hand to pay retirement benefits in Social Security. They come from current taxes.

Narrator:
CalPERS is governed by a 13 member Board of Administration. Six are elected from among its membership.

Three are appointed; two by the governor and one jointly by the speaker of the assembly and the senate rules committee, four are ex-offcio members.
Professor Steven Hughes:
There are some legitimate public policy issues involved in making pension decisions. But the key is to not have investment decisions made on the basis of partisan politics.

Narrator:
CalPERS uses investments to fund its guaranteed benefits. Over the years, CalPERS has developed highly sophisticated strategies for managing its investments.

Professor William Sharpe advises CalPERS. He is Professor Emeritus of Finance at Stanford University and a Nobel laureate. The Professor won the Prize in 1990 for his work on the pricing of financial assets.

Professor William Sharpe:
Obviously, running an investment fund of the size of CalPERS is a challenge. It's a big job and the way in which CalPERS has gone about it is to divide the task in a hierarchical manner so that the board deals with the big decisions, how much should be invested in U.S. stocks, how much in international stocks, how much in fixed income, in cash, alternative investments, real estate.

Narrator:
Every two to three years, the CalPERS Board of Administration gathers for a daylong asset allocation workshop where they set CalPERS investment policy.

Professor William Sharpe:

The big decision is the asset allocation decision. And that is taken with great care and with a lot of attention at CalPERS. The first step involves creating an engine that can project a range of outcomes for the fund for a given asset mix and that engine, if you will, is built by a combination of outside consultants, the staff, consulting actuaries, and it uses a technology called Monte Carlo' simulation which allows you, for a given asset mix and all the attributes of the fund and the actuarial process, to find the range of things that could happen, to generate thousands of scenarios.

Within time then, there is a convergence to the point at which there is a consensus of the relative importance of the decision factors and, therefore, the relative desirability of the candidate asset mixes.

Narrator:
The goal of CalPERS' investment management is to fund member benefits through increased investment returns, thereby minimizing employer contributions.

Each year between July and October, CalPERS actuaries and staff calculate the employer contribution rates for the upcoming year for over 2,500 public agency plans. A separate rate is calculated for each plan. The rate depends on several factors, including:

- The benefits specified in the contract, actuarial factors related to age trends, inflation, and the rate of pay increases
- The amount of assets in the individual employer's account, and the investment performance of the entire pension fund

Professor Steven Hughes:
It's been said that for every dollar earned by investment by CalPERS is a dollar saved to the taxpayers of California. CalPERS has both a secure investment strategy but also an aggressive investment strategy, for instance, it diverts some of its investment funds into venture capital.

This generates tremendous amount of economic growth in the State of California which is a benefit, but also provides solid investment return reducing the potential taxpayer burden."

Narrator:
The sheer size of CalPERS investment fund makes it capable of a variety of investment management approaches and policies that greatly reduce risk.

One such policy is indexing, which means buying domestic stocks in relative proportion to the market itself.

Professor William Sharpe:

The stock portfolio, a large part, is managed internally but using what's called an indexing strategy. So, it's designed to replicate the market as a whole with some constraints.

In addition, U.S. stocks and international stocks are managed, to some extent, by external managers. Typically, they are given particular charges for emphasizing particular parts of the market."

Within the bond portfolio, by and large, it's managed internally and somewhat actively. So, there is discretionary management, if you will, bond by bond.

In the alternative investment and the real estate the management is largely if not exclusively external to the fund. So, it varies quite a bit and the issue in every case is a trade off in terms of costs and benefit of internal management versus external.

Narrator:
Because of its size, CalPERS has the ability to impact the efficiency of other organizations as well.

Beginning in the 1980's, CalPERS made a formal public commitment to a Corporate Governance Program. In 1996 CalPERS expanded the program to include International Corporate Governance.

Basically, what CalPERS does is to monitor the behavior of corporations in terms of their cost effectiveness because, obviously, this has an impact on CalPERS investments. If CalPERS sees something that's a bit amiss or is negatively influencing the bottom line for a corporation, CalPERS will engage in discussions with that corporation.

Narrator:
CalPERS has grown to be a strong, reliable institution, and continues to carry out the pioneering vision of an earlier generation.

This is demonstrated by a strong customer focus in its comprehensive communication with its members. It responds to questions and concerns through all possible means, using a broad range of communication technologies.

Bob McCrory:
Over the years what I've concluded is that CalPERS is a really great organization. They provide outstanding benefits, very low administrative cost and excellent investment performance. I think the people of California are getting a great deal.